New LB&I Campaign Consistent with Increased IRS Focus on Partnership Tax Compliance

On February 7, 2022, the IRS's Large Business & International Division ("LB&I") announced a new compliance campaign focusing on partnership losses in excess of a partner's basis. The campaign will center on ensuring that partners reporting flow-through losses from partnership have adequate outside basis to deduct them. If a partner does not have adequate outside basis in its partnership interest, Section 704(d) requires the losses to be suspended. The IRS explained that the campaign was identified through data analysis performed by LB&I and through suggestions from IRS employees. The campaign aims to improve return selection and identify issues with the greatest risk of non-compliance.

The new compliance campaign is consistent with the IRS's efforts to increase scrutiny of pass-through entities. In particular, in late 2021, the IRS launched its Large Partnership Compliance Pilot Program (the "LPC Program") that uses data analytics to identify partnerships having the most risk of non-compliance in its continued effort to ramp up enforcement. The LPC Program—which targets partnership returns with over $10 million in assets—covers partnerships with complex structures and tax issues.[1] An LB&I memorandum provides interim guidance on the "focused approach" to the execution of the LPC Program, along with insight into its goals.[2]

In order to identify partnerships qualifying for the LPC Program, LB&I uses data analytics—comparable to those used for the Large Corporate Compliance Program—that are adjusted to account for the "unique characteristics" of the partnership population.[3] Once the population is identified and stratified, LB&I applies a threshold to select partnerships it considers large. The processes and factors used to identify large partnerships may change as LB&I becomes more familiar with implementing the LPC Program.[4] Eligible partnerships are then subject to data analytics and classification processes, including classifications relating to Subchapter K issues specific to partnerships and operational issues not unique to partnerships.[5] LB&I plans to enhance its machine learning models that identify non-compliant returns over time.[6]

In its memo regarding the implementation of the LPC Program, LB&I explains how LPC audits will differ from other partnership audits, including that agents will not have discretion to skip issues identified for audit in order to improve the data metrics for future audit selection.[7] Given this emphasis on improving knowledge, LB&I will be requesting "robust" feedback from its examiners on all technical and procedural issues at "defined milestones" during each exam for at least the first two years of the LPC Program.[8] LB&I will gather technical feedback on pre-identified risk profile issues, and any large, unusual, questionable items identified via the LB&I Taxpayer Registry system.[9] The feedback—which will be used to improve modeling,

[1] LB&I-04-1021-0017.
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] *Id.*
[8] *Id.*
[9] *Id.*

classification, and exam processes—will be stored in an internal SharePoint made available to executives, managers, and examiners throughout LB&I, and LB&I will engage in regular networking calls to offer further directions on LPC issues.[10]

Conclusion

Given the IRS's agency-wide emphasis on civil enforcement against large pass-through entities and LB&I's newly launched compliance campaign, partnerships should expect to see an increasing number of audits, including under the LPC Program, in the coming months. Partnerships should watch for additional guidance from LB&I as the division receives, processes, and implements the extensive feedback it plans to gather through the LPC Program over the next two years.

[10] *Id.*